IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

J. B. LINCOLN, as Trustee in Bankruptcy of the Estate of the WENATCHEE HEIGHTS ORCHARD COMPANY, a Corporation, Bankrupt,
Appellant,

vs.

L. V. WELLS,
Appellee,

In the Matter of the WENATCHEE HEIGHTS ORCHARD COMPANY, a Corporation, Bankrupt.

No. 2358.

Brief on Behalf of J. B. Lincoln, as Trustee of the Estate of the Wenatchee Heights Orchard Company, a Corporation, Appellant.

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STATEMENT OF FACTS.

Between the years 1903 and 1906, L. V. Wells, the claimant, E. H. McPherson, A. C. McPherson and W. C. Stewart acquired practically twelve hundred acres of land in the vicinity of Wenatchee, Chelan County, Washington, a large part of which was suited for and intended to be developed as apple orchards. (Record, pp. 76 and 77.) The total purchase price of this property was approximately sixty-eight thousand dollars. (Record, p. 77.) A portion of this purchase price was paid by placing

a mortgage of fifty thousand dollars upon the property and using approximately thirty thousand dollars of this amount towards paying for the property, and the balance in improving.

In the year 1907 there was formed by L. V. Wells and E. H. McPherson the Wenatchee Heights Orchard Company, the bankrupt herein. This corporation had a capital stock of seventy-five thousand dollars. Wells transferred to the bankrupt corporation all of the property thus acquired by himself and the three others, in consideration of the assumption by the corporation of the mortgage of fifty thousand dollars, the issuance to him of all of the capital stock of the corporation as fully paid, and the payment by the corporation of the following sums:

To L. V. Wells, $40,000.00; to E. H. McPherson, $5,850.00; to A. C. McPherson, $7,500.00; to W. C. Stewart, $1,890.00. These last four amounts were paid by the issuance by the corporation of its notes, and the note to L. V. Wells of $40,000.00 is a part of the indebtedness claimed by him at the present time, and it was allowed by the court below. (Record, p. 79.)

Immediately after the organization of the cor-

poration and the transfer to it of the property, it platted about one-half of the property into orchards and actively commenced the sale thereof. The total selling price of the property was approximately three hundred and forty thousand dollars. (Record, p. 79.) It was sold, however, upon contract which provided that the payments should extend over a period of from five to seven years, without interest, during which time the corporation should care for, cultivate and irrigate the property without cost to the purchaser, and should pay all taxes and assessments levied upon the same. (See Exhibit "A" to original petition, Record, p. 8.)

The capital stock turned over to Wells was then divided equally between himself and E. H. McPherson. These two were, at all times, the only officers, trustees and stockholders of the bankrupt corporation.

There is in the record no absolutely definite testimony as to the respective interests of the four men who owned this property prior to incorporation. The most definite is the statement of E. H. McPherson, on page 72 of the printed record, that the interest of Stewart was about one-half as large as his (McPherson's). It is also admitted that the notes received by Stewart and A. C. McPherson at the

time of the incorporation were in full payment of their interest in the property.

The bankrupt continued to sell the same under the contracts before mentioned without any legal obstacles being encountered until the year 1911. At that time one of the purchasers commenced an action for damages, by reason of the failure of the corporation to furnish sufficient water under its contracts. Judgment was recovered in that action, and subsequently paid. In the following year another action was commenced by another property owner, upon the same grounds, and judgment was recovered, which was appealed and subsequently affirmed by the Supreme Court of the State of Washington. (*Hotchkin vs. Wenatchee Heights Orchard Company,* 134 Pacific 1055. (Record, p. 100.) About the time that this second suit was instituted, Wells and McPherson realized that if it was possible for these parties to obtain judgment, it would be possible for all the other purchasers of land to also secure judgment, and thereupon there was originated a scheme which is fully set forth in the opinion of the court below, found on page 132 of the record. At a meeting of the trustees of the Wenatchee Heights Orchard Company, (the trustees being the appellee herein and McPherson),

a proposition was made by one B. E. Gates in which Gates asserted that he owned notes of the Wenatchee Heights Orchard Company issued to Wells and McPherson, one of which was the $57,000.00 note upon which the claim of Wells is in part based and the other in favor of McPherson, the remaining trustee, and that in payment of these notes he would take certain property described in the proposition. This proposition was accepted by the Board of Trustees and the property was thereupon transferred to the Summit Investment Company, which had been organized by Gates for the express purpose of taking title, and in which Gates and his wife owned all the stock. The reason for this entire deal is set forth in the testimony of Wells, quoted by the court below and found in the statement of evidence at pages 90 and 91.

The remaining purchasers of land commenced an action before the Public Service Commission of the State, as the result of which an order was entered finding that the corporation had, at no time, furnished the amount of water it had contracted to furnish, nor the amount necessary to properly irrigate the lands sold by it, and required it forthwith to enlarge its reservoir so as to have additional facilities. (Record, p. 101.)

In December, 1913, an action was commenced in the Superior Court of King County, Washington, by persons claiming to be creditors, against the Wenatchee Heights Orchard Company, the Summit Investment Company, Wells, McPherson and Gates, in which it was sought to set aside conveyances to the Summit Investment Company. In that action a temporary receiver was appointed. Attempts were made to settle the litigation and as a result an agreement was entered into betwen the parties to the action, which is fully set forth, beginning at page 93 of the printed record, as a result of which all the stock of the Summit Investment Company was transferred to one Benninghausen, as trustee, it being stipulated that the proceeds of the property and the rentals derived therefrom were to be used for the purpose of paying the obligations of the Wenatchee Heights Orchard Company. These attempts at a settlement resulted, however, in failure, and a permanent receiver was appointed in the state court. This receiver collected rents and profits from all the property of the corporation, including that transferred to the Summit Investment Company. Thereafter proceedings in bankruptcy were filed and an adjudication followed. Some time after the appointment of a Trustee in Bankruptcy

the Summit Investment Company, at a special meeting of its stockholders and all its Trustees, by resolution, reciting that the conveyance to the Summit Investment Company had been declared by the District Court of the United States in the bankrupt proceedings to be in fraud of creditors of the Wenatchee Heights Orchard Company, directed its officers to execute a deed of the property to the Trustee in Bankruptcy. This was accordingly done.

The appellee, L. V. Wells, filed a claim in the sum of $73,071.26, based on two notes, one for $57,000.00, and one for $20,708.31, and certain other items not now in controversy, and conceding an offset of $7,000.00. The two notes are made up of the original note of $40,000.00, given in part payment for the land, and of an alleged balance due for commissions. The latter claim was totally disallowed by the Referee. The claims in addition to the two notes were not contested by the Trustee, leaving as the only portion of the original claim in dispute at the present time that portion of the $57,000.00 which represents the $40,000.00 note originally given at the time of the incorporation of the company, together with the accrued interest thereon.

In addition to this, the Trustee claims that the transactions between Gates and the Wenatchee

Heights Orchard Company represented by Wells and McPherson constituted payment of the $57,000.00 note, and that therefore there is nothing whatever now due upon the same.

SPECIFICATION OF ERRORS RELIED ON.

I.

That the court should have held that there was nothing due from the corporation to L. V. Wells, but that on the contrary it should have held that the said Wells was indebted to the corporation in the sum of seventy-five thousand dollars for his subscription to the capital stock of the bankrupt.

II.

That the court should have held that the note for fifty-seven thousand dollars attached to the proof of claim and upon which the claim was in part based was fully paid and satisfied.

III.

That the claim of L. V. Wells should have been disallowed *in toto*.

BRIEF OF THE ARGUMENT.

I.

The alleged payment of the capital stock by the transfer of the land was a mere fiction and Wells should now be held for the amount of the capital subscribed for by him.

Camden vs. Stuart, 144 U. S. 104.

2 *Clark & Marshall on Corporations*, 1244.

Adamant Mfg. Co. vs. Wallace, 16 Wash. 614.

Lantz vs. Moeller, 34 Wash. Dec. (Advance Sheets) 309.

II.

There is a presumption in law that the written accounting between the parties was unfavorable to Wells as he did not produce it or explain its absence.

Kirby vs. Tallmadge, 160 U. S. 379.

Runkle vs. Burnham, 153 U. S. 216.

Graves vs. United States, 150 U. S. 118.

III.

Wells is estopped to claim that he did not transfer the note for $57,000.00 to Gates.

Aborn vs. Rathbone, 8 Atl. 677.

IV.

The conveyance to the Summit Investment Co. being actually not only constructively fraudulent and Wells having participated in the fraud he cannot now recover the consideration for the transfer.

Railway Co. vs. Soutter, 12 Wall. 517.

Burt vs. C. Gotzian & Co., 102 Fed. 937.

Lynch vs. Burt, 132 Fed. 417.

Sabin vs. Anderson, 40 Pac. 870.

In re Friedman, 164 Fed. 131.

Ferguson vs. Hillman, 12 N. W. 389.

Kurtz vs. L. Voight & Sons, 75 S. W. 386.

2 *Moore on Fraudulent Conveyances*, p. 644.

Bump on Fraudulent Conveyances (4th Ed.) 445.

V.

The property not having been returned till after adjudication and the election of a trustee, the claim cannot be proved, as its validity must depend upon its status on date of filing petition.

Bankruptcy Act, Sec. 63.

Colman vs. Withoft, 195 Fed. 250.

Watson vs. Merrill, 136 Fed. 359.

ARGUMENT.

I.

The court below found that the original transaction between Wells and the Wenatchee Heights Orchard Company, by which Wells transferred to the bankrupt the land which later became embraced in the Wenatchee Heights Orchard Tracts, was not so fraudulent, nor was the property taken by the bankrupt at such an excessive valuation that the Trustee can now complain thereof. In other words, it was held that this sale constituted a fair payment of the capital stock of the bankrupt. We believe that a fair reading of Wells' and of McPherson's testimony indicates that, in truth and in fact, the real consideration for the transfer of this land by Wells to the Wenatchee Heights Orchard Company was the execution by the corporation of the notes mentioned in the proposal, and that the capital stock was a mere gift or bonus.

McPherson testifies that he had about a one-quarter interest and that Stewart's interest was about one-half of McPherson's. For this interest Stewart received $8,890. Eight times that amount would be in the neighborhood of $70,000. The total amount of the notes given to the four men at the

time of the transfer was $62,000. A. C. McPherson had approximately a one-eighth interest and he received $7,500. Eight times that amount would be approximately $60,000. Is it conceivable that A. C. McPherson and Stewart, if they believed this property to be really worth $200,000, would have taken these amounts for their one-eighth interests. It is admitted on all sides that these amounts were received by them in full payment of their interest in the land. Why should Stewart and A. C. McPherson present to Wells and E. H. McPherson approximately $150,000? No explanation is given by Wells.

It is true that Wells and McPherson both testified that they considered the property worth $200,000, and it is also true that no other testimony was offered by either party. The court, however, is not obliged to accept the valuation of one of the parties to the suit, where no basis for it is shown and where the parties' expert knowledge is, at best, very slight. Wells and McPherson both testified that there had been, at the time of the incorporation, a written statement of account between the four partners in the business and that this statement showed the valuation then placed by them on the property. Each testified that he did not know where that

document now was, but that he believed he had it. Record, pp. 73 and 80.) Wells was recalled thereafter to the stand by his own counsel. No explanation was given by him as to whether he had made any search for the statement, whether he had found it, or whether he had been unable to find it. The reasonable presumption, in fact the only presumption that can be indulged in, in fairness to his counsel, is, that if such a document ever existed, and if the document did show what Wells and McPherson both testified it did, that the partner settled on a basis of $200,000, that the first question which would have been asked Wells would have been, whether he had searched for the paper and whether he had been able to discover it, and, having discovered it, to produce it. Not a single word, however, was heard from them upon the subject of this statement.

Counsel make much of the fact that the property in this case was sold for a total selling price of $340,000, and that this shows it was worth $200,000 when conveyed to the corporation. We might equally as well say that the property was purchased for $68,000 by Wells and McPherson and their partners, and that shows it was not worth more than $62,000 of notes for which it was trans-

ferred to the corporation, after it had been encumbered by a mortgage for $50,000. It is true that the property was sold for $340,000, but the property was not sold for cash. The property was sold under a contract which provided that the payments were to extend over periods of time ranging from five to seven years, without interest. The corporation was to plant orchards upon the property and during the whole time of payment and for one year thereafter it was to care for, farm and irrigate the land without cost. In addition to this, the corporation agreed to pay fifteen per cent commission upon the sale of the land. It also agreed to deliver two acre feet of water per acre per year to each one of the purchasers. That stipulation was of the utmost value to the purchaser. Without the water the land was worthless. With the water it was worth the high price which they paid of about $500 per acre, and the record in this case shows that it has been judicially and conclusively determined that they never had two acre feet of water per acre per year, and never could deliver it. In other words, what was sold was not the property which the bankrupt purchased of Wells and his partners, but that property together with an agreement to deliver more water, sufficient to make the project a paying or-

chard property, and it was that difference between the water which Wells actually conveyed to the bankrupt and the water which the bankrupt agreed to turn over to its purchasers, but failed to do, that made the value of the land. So that we can deduct, first, from this $340,000, fifteen per cent commission, or $51,000. Deduct also the mortgage of $50,000, because the property was to be conveyed for this $340,000, free of encumbrances. Now it is well known that land sold in small tracts brings approximately twenty-five per cent more, at the very least, than land sold in blocks of twelve hundred acres, so that from the $340,000 one should also deduct this amount, or approximately $85,000, bringing the net value of the land down to $155,000. This leaves out of consideration, absolutely, the cost of irrigating, planting and plowing and caring for six hundred acres of orchard lands for a period of seven years. It leaves out of consideration, absolutely, the fact that the corporation never had, and never delivered the water which it agreed to by these contracts aggregating this amount of $340,000, so that, without these considerations, we find the property was estimated by Wells and McPherson, when they came to sell it on behalf of the corporation, at a price of $155,000, with the obligation on the corporation's part to care for it for

seven years and to deliver additional water. It had been purchased by Wells and McPherson for $68,000. They had encumbered it for $50,000 and they sold this equity to the corporation for $132,000. The most that the corporation could receive for the equity was $155,000. Out of this they had to pay the entire cost of planting six hundred acres of orchard, of caring for them and developing them for seven years. This Mr. Wells himself estimates at $100 per acre, or $60,000, which leaves a net value of $95,000, and this $95,000 was upon the basis that the corporation agreed to deliver twice the water that it actually had. That this is not a mere matter of abstract mathematics is shown by the fact that the Wenatchee Heights Orchard Company in its ledger, which was offered for evidence, entered the value of the real estate purchased by the corporation from Wells at $92,800.

We submit that this testimony falls short of showing that this property was worth the $200,000 that Wells and McPherson now claim. It shows that at the time they believed it to be worth just exactly what they paid for it; that the agreement between the four partners was that they were to transfer the property to the corporation, that each of them was to receive a note for the amount he

had in the property, and that Wells and McPherson, who were to take it over, were to have whatever stock their own corporation issued for their profit in handling it. Why else should the other two men, who were parting with their interest in the property, permit Wells and McPherson at the same time to have notes? They parted with everything and they had no security prior to that of Wells and McPherson themselves. In fact, if the corporation failed, Wells, by reason of his larger note, would have been in absolute control.

The law was very well stated by Mr. Justice Brown, in *Camden vs. Stuart*, 144 U. S. 104-113:

> "It is the settled doctrine of this court that the trust arising in favor of creditors by subscription to the stock of a corporation cannot be defeated by assimilated payment of said subscription, nor by any device short of an actual payment in good faith, and while any settlement or satisfaction of such subscription may be good as between the creditors and the stockholders it is unavailing as against the claims of the creditors. * * * Nothing that was stated in the recent cases of *Clarke vs. Bever*, 139 U. S. 96; *Fogg vs. Blair*, 139 U. S. 119, or *Hendlin vs. Stutts*, was intended to overrule or qualify in any way the wholesome principle adopted by this court in the earlier cases except as applied to the original subscribers of the stock."

In Vol 2 Clark and Marshall on Corporations, page 1244, the rule is also laid down:

> "In this country it is well settled that a court of equity, and in some jurisdictions, under the statutes, a court of law, may compel full payment for stock, contrary to the actual agreement between the stockholders and the corporation when such payment is necessary to prevent a fraud upon the creditors of the corporation. Since the capital stock of a corporation constitutes the basis of its credit, persons dealing with a corporation have a right to assume, unless there is something to show the contrary, that the full amount of its issued capital stock has been actually paid in or secured to be paid in, either in money or its equivalent, so that it may be reached, if necessary, for the satisfaction of corporate debts. As a general rule, therefore, any agreement between a corporation and its stockholders under which its capital stock is issued and falsely held out to the public as full-paid, when it is not paid for at all, or is paid for in part only, either in money or in property, labor, or services, while it may be binding as between the corporation and the persons to whom the stock is issued, or their transferees, and as against other stockholders who participate, consent or acquiesce, and as against creditors who have not dealt with the corporation on the faith of such stock being full paid, is invalid as against creditors who have dealt with the corporation on the faith of the stock being full-paid; and the agreement will be set aside or disregarded in equity, or, by statute in some jurisdictions, even at law, and full payment for the stock enforced, at the instance of creditors, or of a

receiver or other person representing them, if such payment is necessary for the satisfaction of their claims."

The rule in the State of Washington was laid down by the Supreme Court in the case of *Adamant Mfg. Co. vs. Wallace,* 16 Wash. 614-617. After announcing its adherence to the trust fund doctrine the Court says:

"This being true, then it must necessarily follow, for the protection of those who dealt with these corporations that the stock subscribed for must be paid for in cash or in property of an equivalent value. In other words, the corporation must be in the actual condition which it represents itself to be in financially. If it were allowed to hold itself out to have a capital stock of $100,000 when the capital stock, which is, and must be under the theory of the law, assets in the hands of the corporation, is worth only one-half that amount, the corporation to that extent is doing business under false colors, and is obtaining credit upon the faith of an asserted estate which is purely fictitious. And where by any arrangement between the corporation and the stockholders the stock is issued as fully paid up, when in fact it has not been paid to the full extent of its face value but has been paid in property of a fictitious or inflated value, a court of equity will compel a payment by the stockholder for the benefit of the creditor who has dealt with the corporation relying upon the asserted value of its assets to the full amount or face value of the stock. Such is almost the universal holding of the courts of the present day."

The last word in the State of Washington on the question of the payment of capital stock by transfer of property was spoken by the Supreme Court on November 28th, 1913, in the case of *Lantz, Receiver, vs. Moeller*, 34 Wash. Dec. (Advance Sheets) 309. In that case, after stating that the decisions of the court have not been harmonious upon the subject the court quotes with approval a portion of the paragraph just quoted by us from *Adamant Manufacturing Co. vs. Wallace, supra*, and then says:

> "We think that the rule as laid down in the *Adamant* case is not only legally but ethically sound and all the decisions of this court which are not in harmony with the views therein expressed are overruled."

Authorities could be cited as indicated in the opinion in the *Adamant* case from which we have just quoted, from almost every State in the Union. The question is not so much one of law, however, as one of fact. That must be determined from the circumstances surrounding each case. In the case at bar we believe that the record shows that the real transaction was the transfer of the land for the notes and that the capital stock was a mere bonus.

In considering this feature of the case it should be borne in mind that, as pointed out, the appellee

Wells testified that when the corporation was formed he and his partners made up a written statement of their account which showed the value they placed upon each separate piece of property. He said that he was not sure what had become of this memorandum but that he might have it in his possession. Although recalled to the stand by his own counsel at a later date he made no explanation of his failure to produce the paper. He did not claim to have searched for it or attempted in any way to bring it before the court. Under these circumstances the presumption is that the document if produced would contain evidence which is unfavorable to the witness.

Kirby vs. Tallmadge, 160 U. S. 379.
Runkle vs. Burnham, 153 U. S. 216.
Graves vs. United States, 150 U. S. 118.

II.

Of one set of material facts in the record there is and can be no question whatever. Those are with relation to what actually took place at the meetings of the Wenatchee Heights Orchard Company at which the conveyances to the Summit Investment Company were authorized. Those minutes are found at pages 82 to 85 of the record, and they

set forth fully and completely all that was done. There were only two men who were present at those meetings. There were only two men who had any interest in the Wenatchee Heights Orchard Company or in the property to be conveyed by it. Those two men were Wells and McPherson. If there was any fraud in connection with this transfer, they, above all men, must have known of it and participated in it. At that meeting it was represented by Mr. Gates, in a letter which was read to the meeting, among other things, that he was the owner of the $57,000 note attached to the proof of claim of L. V. Wells filed in this case. As a consideration for that note and one other issued to McPherson he offered to take the property described in his letter. Wells and McPherson accepted the transfer and carried out the contract made by the offer and its acceptance. On the faith of the statement in Gates' letter that he was the owner of this note the corporation acted and conveyed its property. That representation to the corporation was made by three men—Gates, Wells and McPherson. They all took part in representing that the note had been transferred by Wells to Gates and that Gates was now the owner of it, and, on the strength of their representations, they induced the corporation to transfer practically all

of its assets in payment of the note. The property that the corporation conveyed in the payment of these notes was valued by Gates himself, in the proposal, at $108,000. It is now claimed by Wells that this note, which he represented to the corporation, of which he was president and trustee, had been by him conveyed to Gates, was not, in fact, so transferred; that, as a matter of fact, he wilfully falsified the record of the Wenatchee Heights Orchard Company, and induced that corporation to transfer property, which he then believed was worth over $100,000, in payment of a note which the person to whom the property was conveyed did not own, did not have possession of, and did not have the slightest interest in. In other words, that by a deliberate misrepresentation to the corporation, and by a deliberate falsification of its books, he induced the corporation to transfer, for his benefit, over $100,000 of the property without the slightest benefit to it whatever; on the one hand representing to the corporation that it would be paying a note for $57,000, which he had transferred, and, on the other hand, holding the note himself and insisting that it was then and at all times thereafter a valid outstanding obligation of the corporation.

It is, we believe, a well settled proposition of

law that a person who persuades another by means of his representations to do an act, or part with property, the person making the representations is forever estopped from denying the truth of those representations. If there is any distinction between the corporate entity and those who compose the corporation, then surely Wells, in this case, is estopped as against the corporation to deny that he had, at the time of the transfer, transferred the note for $57,000 to Gates.

In the case of *Aborn vs. Rathbone*, 8 Atl. 677, the Supreme Court of Connecticut had before it a case where the plaintiff brought suit upon an account; payment was pleaded and there was offered in evidence a receipt reciting that it was in full payment. The answer to this was, that the receipt was marked "in full" in order that, by showing this receipt in full to his other creditors the defendant would be enabled so much the more easily to procure a settlement from them on favorable terms, and that it was agreed between the plaintiff and defendant that, as between them, the receipt should be considered only as on account. The court says:

> "The general principle laid down with regard to receipts in full has long been the settled law of this state, whatever it may be elsewhere. The receipt in this case, unless im-

peached for fraud or mistake, was valid and discharged the whole debt though given for a payment that was in itself but a part of the entire debt, and, while the receipt, if obtained of the plaintiff by fraud, would be of no validity as against him, yet where it was given, as the jury must have found it to have been, as a part of a scheme for enabling the defendant to defraud his other creditors, it is clearly well settled law that the plaintiff cannot avail himself of that very fraud to set the receipt aside. No principle is better settled than that a man can never set up his own fraud for his own benefit."

III.

The holding of the Referee below was that, notwithstanding the fraudulent character of the transfer to the Summit Investment Company, still, the property being now in the possession of the Trustee in Bankruptcy, it was not equitable that he should hold the property and that the notes, in payment of which the property was transferred, should be considered paid. The District Judge also held that the transaction between the Wenatchee Heights Orchard Company and the Summit Investment Company was a scheme to hinder, delay and defraud creditors; that it was not only fraudulent in law, but that it was also fraudulent in fact, and that the fraud was by Wells and McPherson; so much so, that he considered some punishment neces-

sary, and for that reason held that, as to the property transferred, Wells should not receive any dividends until all other creditors were paid in full. Our contention is that, the notes having been paid, they were paid absolutely and finally; that the fact that the Trustee later managed to recover this property from others could in no wise inure to the benefit of those who were guilty of the fraudulent scheme.

The question as to whether or not a grantee in a conveyance to hinder, delay or defraud creditors, who is himself a party to the fraud and an active participant therein, can recover the consideration when he returns the property, or can, as a condition of its return, insist that he be repaid the consideration, is not a new one. The rule was laid down very clearly by Mr. Justice Bradley in *Railroad Company vs. Soutter*, 13 Wall. 517-523:

> "The bare statement of the claim, even presenting it in the language of the bill itself, seems to us sufficient to condemn it. Who are the complainants? Are they not the very bondholders, self-incorporated into a body politic, who through their trustees and agents effected the sale that was declared fraudulent and void as against creditors and made the purchase which has been set aside for that cause? Was it ever known that a fraudulent purchaser of property, when deprived of its possession, could

> recover for its repairs, or improvements, or encumbrances lifted by him whilst in possession? If such a case can be found in the books we have not been referred to it. Whatever a man does to benefit an estate under such circumstances he does in his own wrong. He cannot get relief by coming into a court of equity. By the civil law the possessor even in bad faith may have the value of his improvements, if the real owner chooses to take them. The latter has the option to take them or require their removal; but this rule has never obtained in common law nor in the system of English equity. One of the maxims of the latter system is, 'He that hath committed iniquity shall not have equity,' and various illustrations of it are furnished by the books."

The Circuit Court of Appeals of the Eighth Circuit had a somewhat similar situation before it in the case of *Burt vs. C. Gotzian & Co.*, 102 Fed. 937. In that case the lower court had set aside an assignment of a sheriff's certificate of sale and had refused to the grantee a return of the purchase price or of the money expended in the payment of taxes and encumbrances. In affirming the judgment the court said:

> "She knowingly took this assignment to defraud those creditors. If she had paid the purchase price for it, and if she had paid six thousand dollars on account of taxes and encumbrances upon the land, she would not be entitled to any allowance for or reimbursement of these sums as against the creditors repre-

sented by the appeal. One who knowingly takes a conveyance or assignment to aid and abet a scheme to defraud creditors cannot hold the fraudulent instrument, or any interest under it, as against the creditors, to secure the amount paid for it, or for the satisfaction of taxes or encumbrances he has paid upon the property it affects.

"*Sands vs. Codwise,* 4 Johns, 98.
"*Railroad Co. vs. Soutter,* 13 Wall. 517-523.
"*Thomas vs. Bickford,* 19 Minn. 17.
"*Roller Mills vs. Ward* (Minn.), 70 N. W. 271.
"*Davis vs. Leopold,* 87 N. Y. 620-22.
"*Swineford vs. Rogers,* 23 Cal. 324."

Another case growing out of the same failure was before the same court in *Lynch vs. Burt,* 132 Fed. 417. In that case the opinion was written by Mr. Justice Van Devanter, now of the Supreme Court of the United States, and in the course of it he says:

"This principle has a recognized application in suits by creditors to avoid or quiet title against fraudulent conveyances or transfers of a debtor's property, where, after a conveyance or transfer, taxes are paid or encumbrances discharged under circumstances which give rise to an equity equal or superior to that of creditors. If the grantee has been a conscious participant in the fraud he is not, as against creditors, entitled to reimbursement for such expenditures.

"*Burt vs. Gotzian & Co.,* 102 Fed. 937.
"*Guckenheimer vs. Angevine,* 81 N. Y. 394.

> "Public policy forbids the reimbursement of a *particeps criminis;* otherwise one would hazard nothing by active participation in such unfair dealing."

In this case, if we apply the doctrine of the court below that, notwithstanding this fraudulent conveyance, and notwithstanding that Wells and McPherson had stripped the bankrupt corporation of nine-tenths of its assets, with the deliberate intention to hinder, delay and defraud creditors, they may now, after the proceeds have been taken from them in legal proceedings, be placed back in the same position as they would have been had they not attempted the fraud, then the bankruptcy act extends an invitation to all who are inclined to fraudulent dealing with their creditors to do so. Nothing whatever is hazarded. A debtor and his dishonest creditor may enter into a fraudulent scheme by which all the property of the debtor is transferred in pretended payment of the indebtedness to the one creditor, with the intention on the part of both debtor and creditor to hinder, delay and defraud creditors. If the scheme is successful, they have the property. If the scheme is not successful and the other creditors, after litigation, are enabled to recover the property, then the creditor who has participated in and been a party to the fraud may still prove his indebtedness.

The Supreme Court of Oregon has expressed itself quite forcibly as to this situation in the case of *Sabin vs. Anderson*, 40 Pac. 870. In that case the debtor was the owner of a large number of accounts. In order to hinder and defraud his creditors he assigned them to the bank. The bank gave him a certificate of deposit for the amount of the accounts, but it was understood orally that the certificate should not be negotiated except upon an explanation that the real agreement between the bank and the debtor was that the certificate of deposit was only to be paid out of the proceeds of the accounts. The bank became alarmed lest the debtor should convey the certificate without the explanation and, as a result, paid to the debtor finally, in order to prevent this happening, about $2,800 and became the absolute owner of the accounts as against him. When a suit was started to set aside the assignment of the accounts to the bank and to compel it to account for the moneys it had received on the accounts, the bank claimed reimbursement of this amount which it had paid Anderson, and the Supreme Court, speaking through Judge Wolverton, said:

> "But Lively and Bently (the bank) contend that, in any event, they ought to have

credit in the account for the $2,800 which they paid to Anderson for the recovery of the outstanding certificates issued by the bank. The functions of a creditor's bill are to pursue a fund, or to restore a right lost by law, and not to visit the fraudulent grantee with damages. If a person had property of which he has obtained possession for the purpose to defraud the creditors of another, he is under no legal obligation to turn it over to such creditors, but, if he is honest, he will restore it to him to whom it belongs that it may be applied in satisfaction of their demands, if wanted. Now, we presume that if such person has honestly parted with what he fraudulently received, before the rights of the creditors are fixed by judgment, and the filing of the bill, he ought to be exonerated from further liability. *Swift vs. Holdridge*, 10 Ohio, 231. But that is not what Lively and Bently have done in this instance. What they did was the result of their solicitude to protect themselves against the acts of Anderson, and not to restore property held by them in fraud of creditors. *How vs. Camp*, Walk. Ch. 427, is a case similar in principle, where lands had been conveyed in fraud of creditors and the fraudulent grantee had disposed of a portion of them to bona fide purchasers and paid a portion of the purchase money over to the fraudulent grantor. In taking the account the court refused to allow credit for the money thus paid over, and, discussing the case, the chancellor says: 'This is not a case of constructive but positive fraud against creditors, in which the grantee is *particeps criminis*. When that is the case, the rule is not to allow the grantee, in taking the account, for any advancement made to the grantor, as it would to the extent of such allowance, be

> giving effect to the fraud, and remove the chief obstacle to third persons assisting debtors in defrauding their creditors, by indemnifying them against pecuniary loss in case of detection.' Spencer, J., in *Sands vs. Codwise,* 4 Johns, 599, says: 'It would not become a court of equity to take a single step to save harmless a party detected in a fraudulent combination to cheat. No right can be deduced from an act founded in actual fraud.' This court, in the exercise of equitable jurisdiction, cannot take an account between the parties to the fraud for the purpose of reimbursing the fraudulent assignees for any money they may have expended for the sole protection of themselves without regard to the right of the creditors."

In the case of *In re Freidman,* 164 Fed. 131, claims were presented against an estate by parties whom the court held, in the opinion, had assisted the bankrupt in the scheme and device to cheat and defraud his creditors. After finding that the scheme and conspiracy existed, Judge Quarles says, at page 143:

> "It is urged, however, with great confidence, that, inasmuch as the evidence shows that the several sums of money represented by the notes were, in fact, advanced to the bankrupt, therefore, these claims must be allowed. It would be a new doctrine, indeed, if a court of equity were called upon to hand back conspirators money which they have embarked in a fraudulent scheme, and by means of which the fraudulent purpose has been effectuated. It has been repeatedly held that,

where a fraudulent conveyance is set aside by a court of equity, no accounting is to be taken of the money which the fraudulent grantee has actually invested to secure the fraudulent conveyance. This contention is disposed of by the following authorities: *Ferguson vs. Hillman*, 55 Wis. 181-190, 12 N. W. 389, is a leading case where a large number of authorities to the same effect are collated and cited in the opinion. This opinion was adhered to in: *Bank of Commerce vs. Fowler*, 93 Wis. 241-45, 67 N. W. 423. See, also, *In re Flick* (D. C.), 105 Fed. 503. *Burt vs. Gotzian*, 102 Fed. 937; *Lynch vs. Burt*, 132 Fed. 417, both of which were decisions of the Circuit Court of Appeals of the Eighth Circuit. The theory of these cases is that, when a creditor participates in a scheme to defraud other creditors, and in furtherance thereof advances money or incurs expense, the entire transaction is contaminated by the fraud, and a court of equity will not practically pay a bonus upon the fraud by returning such an advance or expense."

In the case of *Ferguson vs. Hillman*, 12 N. W. 389, one of the leading cases on the subject of fraudulent conveyances, the court says:

"The rule of law is well established by the courts that a grantee of real or personal estate, when it is shown that the conveyance was made with intent to defraud or to hinder and delay creditors, has no equity as against such creditors to be protected for the amount which he has actually paid out on such purchase. The reason and justice of this rule are apparent when we consider the effect of any different rule upon the rights of the creditors. If the

> fraudulent grantee can be protected for the amount actually paid by him at the time of the fraudulent transfer, then this would happen; the fraudulent debtor would make the sale to avoid the payment of his debts, take the money and leave the country, and the purchaser have knowledge that he intended so to do, and yet be protected for the money so paid, by courts. The rule, as before stated, has been recognized and adopted by this as well as other courts."

In the case of *Kurtz vs. Lewis Voight & Sons Co.*, 75 S. W. 386, an insolvent debtor had sold a portion of his stock. The purchaser gave a chattel mortgage, the purchase being evidenced also by notes. They were then endorsed without recourse by the debtor to his brother. It was admitted that while the sale was made with the intent to hinder, delay and defraud creditors, and while the purchaser had knowledge of the fraud and *particeps criminis*, still, the brother to whom the consideration was paid was innocent and was, also, a *bona fide* creditor of the debtor. The court, nevertheless, refused to allow credit for the amount of these notes. The court says, at page 387:

> "Such a transaction was necessarily voidable at the instance of the creditors, irrespective of the payment by the buyer of the full value of the goods, and also irrespective of the fact that the vendor assigned the notes which he received for the price of the goods to the holder of a valid demand against himself. As to the

latter party, it is true that he could not be compelled to account to other creditors as trustee for their benefit, except upon proofs of participating in the fraud of the vendor of the goods, but this exemption on his part does not extend to the other two parties, the buyer and the seller of the goods. As to the seller, fraud sufficient to sustain an attachment of his property was shown when proof was made of his intent to fraudulently dispose of any part thereof. *Bank vs. Lumber Co.*, 59 Mo. Appls. 317. *Bank vs. Powers*, 144 Mo. Appls. 447. *Bank vs. Russey*, 74 Mo. Appls. 651. *Glacier vs. Walker*, 69 Mo. Appls. 288. Now, when this intention was communicated to a stranger, who at once intentionally aided and assisted in its consummation, did he not thereby necessarily subject the property so taken to the same processes to which it would have been exposed if it had been found still in the hands of the fraudulent vendor? In other words, how did the vendee acquire any higher rights to the property than the fraudulent vendor, if both cherished the same fraudulent purpose in the transfer of the title? The only answer to these questions is that the property was equally open to a suit of the creditor, whether in the hands of a fraudulent vendor or fraudulent vendee."

The rule as to a fraudulent conveyance made with the actual intent to hinder, delay and defraud creditors has been very well stated in *2 Moore on Fraudulent Conveyances*, page 694, where the author says:

"Where a conveyance has been made with

> the actual intent to defraud creditors and is fraudulent in fact, it will not be upheld as against creditors even to the extent of the consideration actually paid by the grantee. It is wholly void *ab initio* and would not stand to any extent as security or indemnity. The grantee, as a general rule, is regarded as *particeps criminis*, or a guilty participant in the fraud and is not entitled to reimbursement, either for purchase money or consideration, or for indebtedness paid, or for liabilities incurred on account of it."

A large number of cases, covering almost all of the States, are cited by the author in support of the text.

In *Bump on Fraudulent Conveyances*, 4th Edition, page 445, it is forcibly stated that:

> "There is no obligation upon anyone to extricate a rogue from his own toils on any other principle. The knave might gain, and could not lose by a dishonest expedient and inducements would be furnished to unfair dealing if the law were to repair the accidents of an unsuccessful trick. A fraudulent creditor, therefore, is allowed to retain the property, not for any merit of his own, but for the demerit of his confederate, in accordance with a wise and liberal policy which requires that the consequences of a fraudulent experiment may be made as disastrous as possible. The law endeavors to environ a debtor with all possible perils to make it appear that honesty is the best policy."

To the same effect was *Sewell vs. Norris*, 58 S. E. 637, 13 L. R. A. (N. S.) 1118; *Burke vs. Koch* (Cal.), 17 Pac. 228; *Biggins vs. Lambert* (Ill.), 73 N. E. 371.

The statement from Bump, quoted above, seems to us to fully answer the contention of Wells in this case, "that there is no obligation upon anyone to extricate a rogue from his own toils." No one is responsible for the record made on the minute books of the Wenatchee Heights Orchard Company, showing that the note now in question was fully paid, except Wells himself. His sole object in making that record was, as he himself said, to make it appear to other creditors of the Wenatchee Heights Orchard Company that it had no property whatsoever out of which they could satisfy their demands. As he himself says:

> "*We were afraid that possibly there might have been—might be others who would be encouraged by that fact that Mr. Hotchkin had obtained a judgment and would enter suits and thus dissipate the resources of the Wenatchee Heights Orchard Company in a way that we thought was not just.* * * *"
>
> Q. And you were trying to put those assets into such shape so that anybody who secured a judgment for the reasons that Hotchkins did would be unable to touch that property, is not that true?

A. No; that was not my idea exactly. *My idea was to put the matter in such shape as to discourage persons who thought of entering suits for causes of that kind.*" (Record, pp. 90-92.)

When discovered, there was not even a pretense made that there was any honest motive whatever for the transfer of the property. There was only one idea in the minds of Wells, McPherson and Gates at the time they made this transfer—that idea was solely the one of putting the assets of the Wenatchee Heights Orchard Company beyond the reach of any creditors. No idea of preference to themselves ever entered their minds. It was a pure case of a transfer with the intent to hinder, delay and defraud creditors.

In a brief filed before the District Court, counsel for Wells relied upon the case of *United States Rubber Co. vs. American Oak Leather Co.*, 181 U. S. 434, and *Hutchinson vs. Otis, Wilcox & Co.*, 190 U. S. 552, to sustain their proposition that, notwithstanding the fraudulent character of the transfer, nevertheless they were entitled, the property having been recovered, to prove their claim.

In the *U. S. Rubber Co. vs. American Oak Leather Co.* it will be seen upon reading the opinion that the whole case turned on the question

as to whether or not there had been actual fraud, as distinguished from constructive fraud. The Circuit Court of Appeals in the same case (96 Fed. 891) had held that the facts constituted a fraud in fact and had denied to those creditors who participated any right to share in the fund until all others were fully paid. It is true that this was reversed by the Supreme Court, but it was reversed solely upon the ground that that court held there was no fraud in fact, but that the fraud was purely constructive or fraud in law. In addition, the Supreme Court pointed out that possibly in bankruptcy proceedings the result reached by the Circuit Court of Appeals might be the proper one, saying, at page 450:

> "The theory of the Court of Appeals, as forcibly expressed in the opinion of Circuit Judge Woods, would seem to be the application to the facts of the case of the principles of the bankrupt law with its feature of forbidding preference. In any event, the decision is based wholly upon the ground that the Supreme Court differs with the Circuit Court of Appeals in its determination that the facts as found constitute a fraud in fact."

The case of *Hutchinson vs. Otis, Wilcox & Co.* was a case in which the sole question was one of preference, without any claim that the facts constituted a fraud.

In the light of all the cases and authorities, and in view of the finding of the court and of the referee who saw and heard the witnesses on the stand that the facts constituted a fraud in fact, it seems to us there is no escape from the conclusion that those who participated therein and who were the instigators of the fraud should not now be permitted to escape the consequences of their own wrongdoings. Any other result permits them to gamble upon the question as to whether a court of equity will discover them in their fraud and so gamble without the slightest chance of loss and with a fair chance of gain.

IV.

There is one additional obstacle to the allowance of these claims. The whole basis, as we have said, on which counsel for Wells, the Referee and the Court below have ever claimed that Wells was entitled to share in the estate at all is on the ground that the property has come back to the estate. Now, if there is one proposition of law that is well settled in the bankruptcy law, it is that the status of a claim depends absolutely upon its condition at the date of the filing of the petition. (Bankruptcy Act, Sec. 63.)

Nothing that happens since that date can in any wise affect the validity of the claim or its provability. The record in this case, made by Wells himself, shows that the property was not returned by the Summit Investment Company until after the filing of the petition, the adjudication, and the appointment of a trustee. This is shown by the stipulation set forth at the bottom of page 96 of the printed record. In other words, on the date of the filing of the petition, and on the date of the adjudication, the Summit Investment Company had not returned this property. It was still in the name of the fraudulent grantee.

While it is unusual to cite as authority a brief submitted by counsel, we feel, in justice to ourselves, that we should cite the following from the brief submitted by the present attorneys for this same claimant in another question arising in this same bankruptcy:

> "That is to say, if any claim against this estate is contingent upon what the trustee may now do or not do, that very fact will render that claim not provable against the estate, for it is the decision of all the late cases that in bankruptcy a claim must turn on its status at the time of the filing of the petition, and no claim contingent upon any subsequent events whatever can be proven.

"*Colman vs. Withoft*, 195 Fed. 250 (C. C. A. 9th Cir.).

"*In re American Vacuum Cleaner Co.*, 192 Fed. 939.

"*In re Inman & Co.*, 171 Fed. 185 (D. C.), cited with approval *In re Merrill & Baker*, 186 Fed. 312 (C. C. A. 2nd Cir.).

"*In re Imperial Brewing Co.*, 143 Fed. 579 (D. C.).

"*In re Roth & Appel*, 181 Fed. 667 (C. C. A. 2nd Cir.).

"*Slocum vs. Soliday*, 183 Fed. 410 (C. C. A. 1st Cir.).

"*In re Gallacher Coal Co.*, 205 Fed. 183 (D. C.).

"*In re Abrams*, 200 Fed. 1005 (D. C.).

"*Watson vs. Merrill*, 136 Fed. 359 (C. C. A. 8th Cir.)."

V.

One other ground of objection to the allowance of these claims appears to us to be quite persuasive. Wells now claims that his ownership of the note was distinct from the Summit Investment Company, or Gates; practically, that they had nothing to do with each other and that his record that the property was transferred to the Summit Investment Company in payment of the note was wholly false. Now, if this is true, how can a reconveyance

by the Summit Investment Company inure at all to the benefit of Wells? The only theory upon which he can insist that he should be allowed to have his claim approved is that *he* has returned the property to the trustee. If he and the Summit Investment Company, or Gates, are distinct individuals, and if the Summit Investment Company, or Gates, did not own his note, and his ownership was not for their benefit, why is he entitled to any special consideration because a corporation in which he has no interest and which he does not control, seeks to return property which he fraudulently conveyed to it?

It has been a recognized maxim of equity ever since courts of equity were established that no man can set up his own wrong. If Wells is to be permitted to prove his claim in this case, that maxim is reversed and set aside. When this claim comes on for proof the situation is very simple. Wells files a claim on a note, setting the note up. The Trustee objects that it has been paid. When testimony is to be taken on that question the Trustee offers in support of his allegation the record of the corporation made by Wells himself, showing that property was transferred in payment of the note which Wells then set up he had transferred. To

rebut that evidence, Wells is compelled to set up the claim that this record is a fraud and a falsehood, that the conveyance was made to hinder, delay and defraud creditors and is, therefore, invalid; that each and every transaction set up in these minutes which he made is false and fraudulent and void, and because it is false and fraudulent and void and because he participated in and assisted in making it he therefore should be permitted to recover on his notes. It seems to us that the mere statement of the position is enough to prove its falsity. It seems so to the Supreme Court of Connecticut in *Aborn vs. Rathbone, supra.*

It is respectfully submitted that the order of the District Court should be reversed and the case remanded to that Court with instructions to enter an order disallowing the claim of L. V. Wells in its entirety.

RAYMOND D. OGDEN and
WALTER SCHAFFNER,
Attorneys for J. B. Lincoln, Trustee, Etc., Appellant.

IN THE UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

L. V. WELLS,

Appellant,

vs.

J. B. LINCOLN, as Trustee in Bankruptcy of the Estate of WENATCHEE HEIGHTS ORCHARD COMPANY, a Corporation, Bankrupt,

Appellee,

and

J. B. LINCOLN, as Trustee in Bankruptcy of the Estate of the WENATCHEE HEIGHTS ORCHARD COMPANY, a Corporation, Bankrupt,

Appellant,

vs.

L. V. WELLS,

Appellee,

In the Matter of WENATCHEE HEIGHTS ORCHARD COMPANY, a Corporation, Bankrupt.

Brief of Appellee L. V. WELLS, upon Appeal of J. B. Lincoln.

Appeal from the United States District Court for the Western District of Washington Northern Division.

The chief exception which we take to the trustee's brief is that counsel for the trustee persist in arguing the law of this case upon the theory that

the claimant is a rascal, and thereupon make their statements of fact to fit that theory, regardless of whether or not those statements are borne out by the record.

Taking a general view of the entire case we would call attention to the fact, as we have mentioned in the appellant's brief upon the claimant's appeal, that Judge Hoyt, who has had many years of experience as a referee in bankruptcy in a district where there has been much business arising from bankruptcies, both fraudulent and honest, had both the claimant and his co-officer McPherson before him personally on various occasions and they were separately submitted to rigid examinations. The trustee had every opportunity to show the falsity of any statements made by the officers of the bankrupt and to unearth fraud if there had been any, and yet Judge Hoyt in his order does not find that this claimant had been guilty of any actual fraud or of any intent to defraud any one, or that any creditor of the bankrupt had ever been hindered, delayed or defrauded.

In this connection we will point out at this time a few of the statements contained in the trustee's brief which are not borne out by the record

and some of which are directly in conflict with the record.

Upon page 7 of the brief of the trustee as appellant, appears the statement that the finding of the Public Service Commission of the state was that the corporation had "at no time" furnished the amount of water it had contracted to furnish. The wording of the record (trans. p. 101) is that the finding was that the bankrupt "had not furnished the water called for by its contracts," which is a very different statement.

At the foot of page 13 of the trustee's brief appears the statement that McPherson testified that he had about a one-quarter interest. What McPherson did testify to was that he had a one-fourth or a one-third interest in the Walker property consisting of one hundred and sixty acres and the Wheeler property consisting of three hundred and twenty acres, and that he had no interest in the rest of the property. (Trans. pp. 70 and 71.)

Again, at the top of page 14 of the trustee's brief appears the statement that "A. C. McPherson had approximately a one-eighth interest and he received $7,500." What the record shows is that A. C. McPherson had a one-half interest in 120 acres (i. e., a one-half interest in one-tenth of the

entire tract) and he received for it $2,000 in cash and a note for $7,500. (Trans. p. 80.)

Upon page 16 of the trustee's brief appears the statement that "it has been judicially and conclusively determined that they never had two acre feet of water per acre per year, and never could deliver it." There has never been any such judicial determination. The substance of the determination of the Public Service Commission of the State of Washington is set out upon page 101 of the transcript, from which it appears that the Public Service Commission found that the bankrupt had not furnished the water called for by its contracts, and required it to furnish plans for increasing its water supply. Thereupon the bankrupt furnished a plan which the Public Service Commission approved, and the estimate of the engineer of the trustee was that the construction of the improvement according to this plan would cost the bankrupt $8,000. The only presumption one can draw from this is that the putting in of this improvement at the estimated cost of $8,000 would enable the bankrupt to comply fully with its contracts.

Upon page 18 of the trustee's brief appears the statement that the Wenatchee Heights Orchard Company, in its ledger which was offered in evi-

dence, "entered the value of the real estate purchased by the corporation from Wells at $92,800." No such entry was made. There is an entry upon the ledger of real estate at $92,800, but whether this is gross value of the real estate itself or of the company's equity in it, or what the company had actually paid out for real estate, does not appear and the trustee's bookkeeping expert testified that these figures might mean any of these things. If the trustee's counsel want to interpolate this ledger entry in the record, we would ask that they also interpolate the entire testimony of their expert witness P. T. Bliss.

At the top of page 23 appears the statement that Wells testified that when the corporation was formed "he and his partners made up a written statement of their account which showed the value they placed upon each separate piece of property." What Mr. Wells testified to is shown upon page 80 of the transcript wherein it appears that he made figures on "pieces of paper," and the witness did not know whether they were yet in existence or not. In other words, they scribbled on various scraps of paper until they arrived at a satisfactory settlement. This is neither a written statement nor a memorandum as it is called in the trustee's brief.

At the top of page 25 of trustee's brief appears the statement that Gates in his proposal valued the property of the corporation at $108,000. He did no such thing. His proposal appears upon page 83 of the transcript, and from that it appears that he stated the total value of this property to be $75,000, subject to a mortgage of $33,500.

Upon page 39 of the trustee's brief appears the statement that Wells' sole object in making the record in the minute book of the Wenatchee Heights Orchard Company was to make it appear to other creditors that it had no property whatsoever out of which they could satisfy their demands. Counsel then pretend to give a quotation from the claimant's testimony, but omit the essential feature of it and that is "if others who had not proper claims against the company were able to recover on judgments, necessarily the assets of the Wenatchee Heights Orchard Company would have been dissipated before we could carry out our contracts; and it was my idea to surround these resources by such safeguards as would prevent their being dissipated in that manner, and to use them for the purpose of carrying out the contracts of the company in regard to their water rights and cultivation of the land."

At the top of page 43 appears the statement that "the record in this case made by Wells himself shows that the property was not returned by the Summit Investment Company until after the filing of the petition, the adjudication and the appointment of a trustee." The record actually shows that this property physically never left the possession of the Wenatchee Heights Orchard Company, as they continued to collect the rents from the property after the conveyance to the Summit Investment Company as well as before. (Trans. p. 97.) All that the Summit Investment Company ever had was a bare legal title and, at the time of the petition in bankruptcy there was outstanding the agreement of December 30, 1912, reciting that all this property was in fact the property, assets and effects of the Wenatchee Heights Orchard Company. Under the Bankruptcy Act the trustee took the legal title to this property upon his appointment just as surely as if that title had been standing in the name of the bankrupt all the time.

I.

THE VALUE OF THE PROPERTY TURNED INTO THE COMPANY.

Upon this subject the referee made the find-

ing that "the transfer of certain property to the Wenatchee Heights Orchard Company by said L. V. Wells on the 9th day of March, 1907, was a valid contract and conveyance and for a fair consideration." (Trans. p. 24.) This finding is approved by the district judge, and in view of the fact that there is absolutely no evidence that this was an inflated value, other than the fact that this property had been purchased several years before (upon a rapidly rising market) at a less price, we think that even if this court should examine this evidence *de novo,* it would come to the same conclusion. The claimant in his testimony (trans. p. 81) taken in June, nearly three months prior to the hearing upon his claim, gives the names and addresses of various persons who had appraised this property. It would have been a very easy matter for the trustee to have produced evidence as to what was the actual market value of that property at the time it was turned over to the corporation, and yet the trustee made no attempt to produce any such evidence. We think that the rule of evidence which the trustee's counsel seeks to apply in their second point (p. 11) would be very applicable against the trustee upon this phase of the question, and the fact that the trustee produced absolutely no direct testimony whatever

as to the value of this property at the time it was turned over to the corporation is cogent proof that the value at which it was turned over to the corporation was, as the referee found, a fair valuation.

The trustee himself testified (trans. p. 97) that the value of the tillable land which could be irrigated from the ditches of the bankrupt, "would be increased about $400 per acre if properly irrigated." In order to properly irrigate this land according to plans which had been approved by the Public Service Commission, it would cost the estate from $5,000 to $8,000. (Trans. p. 101.) In other words, according to the trustee's own estimate an expenditure of from $5,000 to $8,000 would make the tillable land, of which there was at least 600 acres, worth at least $400 per acre.

Counsel for the trustee attempt to prove by the settlement made with Steward and A. C. McPherson, that the parties at that time considered the property worth but $60,000 or $70,000. The trouble with their proof is that they start with incorrect facts. The facts as set forth by the record are as follows:

"(Testimony of L. V. Wells.)

The witness further testified that A. C. McPherson received about $2,000 in cash and a note for

$7,500 as payment in full for his investment; that his investment consisted of a half interest in the Cole 40 acres and a half interest in 80 acres in section 34; that Steward got about $2,000 in cash and a note for $8,890 for his interest; that his interest was scattered around through several pieces of property; that when they organized the company they estimated the value of the property to be $200,000; that he did not recall the values placed upon the various tracts; it was his recollection that Mr. Steward's interest was larger than that of Mr. E. H. McPherson, but that Mr. E. H. McPherson received his interest in the corporation and his note as 'a result of some other deals Mr. McPherson and I had personally.' " (Trans. p. 80.)

From this it will be seen that A. C. McPherson received about $2,000 in cash and a note for $7,500 for an undivided one-half interest in 120 acres (one-tenth of the total acreage) which was subject along with the rest to a blanket mortgage of $50,000. The fact that Steward and A. C. McPherson accepted the unsecured notes of the company showed that they must have thought that the value of the company's assets was considerably in excess of its liabilities.

Upon page 17 of the trustee's brief, appears a weird method of computation by which counsel for the trustee come to the conclusion that this property with the water called for under the contracts was worth about $95,000. We would merely call attention

to the fact that counsel arrive at this conclusion by deducting one sum of $85,000 for the reason that "it is well known that land sold in small tracts brings approximately twenty-five per cent more, at the very least, than land sold in blocks of twelve hundred acres." Inasmuch as there is no evidence whatever as to this interesting fact of expert knowledge, we suppose that counsel expect this court either to take judicial notice of this principle of estimating real estate values or to take their unsworn statements as expert testimony. We fail, however, to see its application in this case inasmuch as this land was valued upon a basis of being capable of division and sale in small tracts.

Taking a proper method of computing the value of this property as it appeared at the time of the organization of the company, the selling price was $340,000; from that, deduct 15 per cent for commissions (which the promoters expected at that time to pay), and $60,000 for the planting, caring for and developing of the 600 acres at the estimated cost of $100 per acre (trans. p. 82), and $10,000 for putting the additional water upon the land, and we have $219,000 as the net value of the land as it appeared at the time of the organization of the company. The promoters put it in at a price of

over $30,000 less than that, which leaves what would be considered an ample margin for contingencies. It is true that the contingencies have been more than $30,000, and the cost of caring for the land has been more than $100 per acre, but if the honesty of a business venture is to be judged by assuming that the promoters at the outset foresaw the outcome, an honest bankruptcy would be a paradox.

In all of the cases cited by the trustee upon this point, it appears that the property was turned over to the corporation at values which were grossly in excess of any honest valuation. The law of the case applicable to a state of facts where the promoters of a corporation turned in property at what was then by a fair estimation its actual market value, but which later depreciated in value, is that the valuation put upon it by the promoters must stand even though the property afterwards proved to be of much less value than was supposed.

Turner vs. Bailey, 12 Wash. 634.

Kroenert vs. Johnston, 19 Wash. 96.

Beddow vs. Huston, 65 Wash. 585.

In re Alleman Hdwe. Co., 181 Fed. 810.

Coit vs. Gold Amalgamating Co., 119 U. S. 343.

In *Coit vs. Gold Amalgamating Co.,* 119 U. S.

343, the promoters of the corporation turned in in payment of its $100,000 capital stock, as appears from the decision, "a machine for crushing ores, the right to use a patent called the Crosby process and the charter of the proposed organization".

Further quoting from the opinion:

"Upon obtaining the charter, the capital stock was paid by the property of the former association, which was estimated to be of the value of $100,000, the shares being divided among the stockholders in proportion to their respective interests in the property. Each stockholder placed his estimate upon the property; and the average estimate amounted to $137,500. This sum they reduced to $100,000, inasmuch as the capital stock was to be of that amount."

The court held that, in the absence of actual fraud, a mere overvaluation would not render such a deal void as against creditors, saying:

"If it were proved that actual fraud was committed in the payment of the stock, and that the complainant had given credit to the company from a belief that its stock was fully paid, there would undoubtedly be substantial ground for the relief asked. But where the charter authorizes capital stock to be paid in property, and the shareholders honestly and in good faith put in property instead of money, in payment of their subscriptions, third parties have no ground of complaint. The case is very different from that in which subscriptions to stock are payable in cash, and where only a part of the installments has been paid. In that case there

is still a debt due to the corporation, which, if it becomes insolvent, may be sequestered in equity by the creditors, as a trust fund liable to the payment of their debts. But where full-paid stock is issued for property received there must be actual fraud in the transaction, to enable creditors of the corporation to call the stockholders to account. A gross and obvious overvaluation of property would be strong evidence of fraud."

Probably the last word in the Federal reports upon this question is the case of *In re Alleman Hardware Co.*, 181 Fed. 810, from the Circuit Court of Appeals of the Third Circuit. The facts in that case are more fully set out in the decision of the District Court, found in 172 Fed. 611. In this case the creditor H. N. Gitt, who was seeking to prove a claim was, at the time of the adjudication of bankruptcy, the sole owner of the capital stock of the bankrupt. He, with one Johns had, prior to the organization of the bankrupt, been partners in the hardware business. At the time of the organization of the company Johns offered Gitt $10,000 for the privilege of getting out of the company and being relieved from liability and this was agreed to, Johns promising to remain and assist in the organization of the new company.

At the organization of the company Johns and Gitt transferred the property and business of the

former partnership to the company for $5,000 and $20,000 common stock of the company, the company to assume all the partnership liabilities which, at that time, amounted to $64,000. In order to make a balanced statement of assets and liabilities it was necessary to put in good will as an asset at $16,000 and leave out contingent claims amounting to $11,000, of which $5,000 later had to be paid. The company, however, did business for several years and then went into bankruptcy, with H. N. Gitt its then sole owner, being a creditor for over $21,000.

The District Court refused to allow this claim but the Circuit Court of Appeals reversed the District Court, saying:

"Now, granting that subsequent events show the partnership was then insolvent, we then have the question, How was any party now before us affected thereby, or how could that issue be involved in this distribution? This company came into existence, and its whole corporate business was based on the stock of goods it obtained from this firm. Its whole business existence and the assets here distributed are founded on the affirmance, ratification and enjoyment of the contract for the sale of the property of Gitt and Johns to the corporation. It sold these goods and mixed the proceeds up in its operations, and the present fund had its origin in property of the old firm. How does it lie in the mouth of the company to at the same time enjoy the property it received and allege the illegality of its

reception? We are not here dealing with a fraud, we are not dealing with a subscription to stock, we are not dealing with the rights of any creditor who was misled; but we are dealing with a case where no party who might have been injured thereby is concerned, where all the creditors of the old firm have been paid, and where there is no proof that any creditor of the new corporation has been deceived or misled by the stock issue complained of. If, then, the rights of no individual creditor are here involved or sought to be enforced, it follows that Gitt's claim cannot be rejected unless the bankrupt company itself has a counterclaim against him. And how can it be said it has? It is true capital stock is a trust fund for the benefit of creditors, and, if stock is fictitiously and fraudulently issued, it may be collected for the benefit of creditors (*Coit vs. Gold Co.*, [C. C.] 14 Fed. 16; *Handley vs. Stutz,* 139 U. S. 436, 11 Sup. Ct. 530, 35 L. Ed. 227); but when, as here, the value of the consideration of the stock was fairly debatable, and the corporation enjoyed, used, and did its entire corporate business for several years on the property conveyed to it, and where the property cannot be restored or the contract rescinded, and where no person here interested was in any way induced to act or was misled or wronged by the maintenance of that *status*, we think the corporation has no such right or claim against Gitt as prevents his unquestioned debt from participating in this distribution. Under these facts, it is clear that this corporation had, prior to bankruptcy, no right of action against Gitt to recover on this stock which was issued to him for his merchandise. And, if such be the case, the *status* of the parties is not changed by bankruptcy, for, as was said in *Thompson vs. Fairbanks, supra*:

"'Under the present bankrupt act, the

> trustee takes the property of the bankrupt, in case unaffected by fraud, in the same plight and condition that the bankrupt himself held it, and subject to all the equities imposed upon it in the hands of the bankrupt.' "
>
> *In re Alleman Hdwe. Co.*, 181 Fed. 810, 813-814.

Counsel for the trustee make much of the fact that both Wells and McPherson stated in their testimony that at the time when the final settlement among the four men was made, there was considerable accounting and computing done on "pieces of paper", and that the claimant has not produced these pieces of paper. If the trustee wanted these pieces of paper produced he could have obtained them or found out whether they were in existence by means of a subpoena *duces tecum*. All that this point amounts to is that in the course of a long cross-examination it developed that some six years prior to this time the parties to a settlement had made various computations upon "pieces of paper". The witnesses were not called to produce them and nothing more was thought of it at the time. Now trustee's counsel argue that this is positive proof of a conspiracy even intimating (p. 15) that claimant's counsel suppressed these documents. Counsel for the trustee should know that Wells might have made

as many statements as he pleased in 1906 that this property was worth $200,000, and none of those statements would have been admissible on his own behalf as they would have been nothing but self-serving declarations. The only way they could properly have been introduced would have been through the trustee requiring their production as cross-examination.

In the last case cited by the trustee upon this point, *Graves vs. United States,* 150 U. S. 118, it was expressly held that it was reversible error for the United States attorney to call attention to the fact that the defendant had not produced his wife as a witness, in view of the principle of law that the wife was not admissible as a witness in favor of her husband, and therefore the husband could not have had the benefit of his wife's testimony.

II.

TRUSTEE'S CLAIM OF ESTOPPEL.

Counsel for the trustee claim that Wells is estopped to claim that he did not transfer the note for $57,000 to Gates. In support of this principle of law counsel cite one case—*Aborn vs. Rathbone,* 8 Atl. 677, from Connecticut, decided in 1886, where

the facts of the case were that the person who presented the receipt was claiming an actual settlement of the claim, and it was admitted that he had paid a consideration for the receipt. It was under this state of fact that the court used the language set forth on pages 26 and 27 of the trustee's brief.

Against this lone case we would place the case of *Thompson vs. Sioux Falls National Bank,* 150 U. S. 231, where the defendant bank had without consideration given to a defaulting county treasurer a cashier's check so that the treasurer could show it to the county commissioners in his settlement. Suit was brought upon the check and the claim was made that the bank, by giving the check for a fraudulent purpose was thereby estopped to deny its liability, but Mr. Justice Brown in his opinion said (p. 244):

"The claim that defendant was estopped by its cheque to deny that the bank was indebted to the county in the amount of such cheque, depends practically upon the same considerations as the question of innocent purchasers. If, upon the faith of such representations, the county commissioners did any act prejudicial to the interests of the county, an estoppel might arise; but if, before such act was done, the commissioners were informed that the cheque was fictitious, they could not be said to have acted upon the faith of its representation and there could be no estoppel."

The absolutely necessary element of an equitable estoppel is that the person against whom the estoppel is claimed must have performed some act or made some statement which has induced the person claiming the estoppel to believe or act to his prejudice to such an extent that it would now be inequitable to permit the person claimed to be estopped to speak the truth. There is absolutely no evidence in this case that any creditor of this estate ever saw the minutes of the bankrupt corporation, or knew of their existence prior to the institution of bankruptcy proceedings, and there is absolutely no evidence whatsoever that any creditor was ever hindered, delayed or defrauded in the slightest degree by any act or conduct of this claimant, or the other persons connected with the Summit Investment Company transaction. The trustee is merely seeking to take advantage of a condition of affairs which never injured any person, to prevent this claimant from obtaining approval of a claim which both the referee and the district judge found valid in its origin, and totally unsatisfied.

III.

TRUSTEE'S CLAIM THAT CLAIMANT'S NOTES WERE PAID.

The next point of the trustee is that "the conveyance to the Summit Investment Company being actually not only constructively fraudulent, and Wells having participated in the fraud, he cannot now recover the consideration for the transfer." There are two difficulties in applying this rule. One is that the conveyance to the Summit Investment Company was not actually fraudulent, and the other is that Wells is not seeking to recover any consideration for that transfer.

We can only judge of a man's motives by what he says and does. Mr. Wells testified that his ultimate motive in making this transfer was to preserve the assets of the estate from being frittered away in damage suits. It was his idea, to use his own words, "to surround these resources by such safeguards as would prevent their being dissipated in that manner and to use them for the purpose of carrying out the contracts of the company in regard to their water rights and cultivation of the land". If this was not the real motive of the participants herein what could have been? Counsel for the

trustee in another portion of their brief state "no idea of a preference to themselves ever entered their minds". (Trustee's brief, p. 40.) It is clear that they were not seeking any personal preference for themselves, as if that had been the case all that they would have had to do would have been to take the property themselves, cancel their indebtedness to the company, and at the end of four months the preference would have been unassailable in bankruptcy. We would then have had conduct which the Supreme Court of the United States has declared not to be fraudulent in fact but only contrary to the provisions of the bankruptcy act if attacked in time.

Instead, however, of grabbing this property for themselves these parties turned over as it accrued all rental arising from the property to the Orchard Company. As soon as the conveyance was questioned they entered into the agreement of December 30, 1912, wherein every one agreed that this property was the property of the Orchard Company. Mr. Wells' motive toward the company and its creditors can be further seen by the fact that subsequent to the Summit Investment Company transaction, he loaned the company over $3,000, a large portion of which he borrowed from the bank for that purpose,

and when a judgment was entered against the company in the summer of 1912 for $1,750 he obligated himself personally upon the company's supersedeas bond to enable the company to appeal to the Supreme Court. We respectfully submit that this conduct is absolutely incompatible with the idea that Mr. Wells set to work deliberately to defraud the persons who had had business transactions with the company.

The claimant here is not seeking to recover back any consideration paid for the transfer to the Summit Investment Company. There was no such consideration. The reason why the transfer to the Summit Investment Company was constructively fraudulent, was that it was without consideration. If Gates had actually had those notes and had cancelled them in consideration of this conveyance, the conveyance would, if timely attack in bankruptcy had been made, have been an unlawful preference against the bankruptcy act, but it would otherwise have been a perfectly good transfer. The only reason why the conveyance was admittedly constructively fraudulent was that it was without consideration, and if it was without consideration Wells cannot now be said to be seeking to recover any consideration paid for such conveyance.

The cases cited by the trustee's counsel in support of this proposition are cases where parties are seeking to recover considerations paid for fraudulent transfers where they were guilty participants in actual fraud. Furthermore, in most of the cases they were seeking to recover the considerations as conditions precedent to the setting aside of the transfers. The law in such cases is clearly not applicable to this case. Also but one of the cases cited by the trustee upon this point was a bankruptcy case, and that case is *In re Freidman,* 164 Fed. 131, where the court refused to find that the claimant ever had a valid claim against the estate, for good and sufficient reasons appearing in the opinion of the court.

We have fully argued this phase of the question upon pages 11 to 26 of our appellant's brief on the appeal of L. V. Wells. We will therefore content ourselves at this time with a reference to that argument and respectfully submit that it is the rule of the Supreme Court both in equity and in bankruptcy that the holder of a valid claim in the absence of the retention of an unlawful preference, is entitled to all the rights of a creditor, regardless

of what his conduct in connection with his claim may have been.

Clements vs. Nicholson, 6 Wall. 299.

White vs. Cotzhausen, 129 U. S. 329.

U. S. Rubber Co. vs. American Oak L. Co., 181 U. S. 434.

Hutchinson vs. Otis, Wilcox & Co., 190 U. S. 552.

Keppel vs. Tiffin Savings Bank, 197 U. S. 356.

Page vs. Rogers, 211 U. S. 575.

We cannot pass this point without calling attention to a very material misrepresentation set forth near the top of page 42 of the trustee's brief. Counsel there mention the "finding of the court and of the referee who saw and heard the witnesses on the stand that the facts constituted a fraud in fact". The referee never made any such finding. As to what the district judge found, who neither saw nor heard the witnesses—his opinion speaks for itself. If he had been satisfied that the claimant intended to defraud the creditors of the bankrupt, he would doubtless have said so in so many words. We would call attention particularly to the language of the district judge when he is referring to the testimony of Wells that "it therefore appears that the scheme

when stripped of its euphony is to hinder and delay creditors". His omission of the word defraud in this connection could not have been an oversight.

IV.

Lastly, counsel for the trustee argue that inasmuch as because at the time of the institution of bankruptcy proceedings, the legal title to this property stood in the Summit Investment Company, this claimant is thereby barred from asserting his claim. Counsel for the trustee in arguing this point overlook the fact that at the time of the institution of bankruptcy proceedings there was a binding contract in existence by which all of the officers and stockholders of the Summit Investment Company had declared this property to be the property of the Wenatchee Heights Orchard Company, and had bound themselves to use this property in the carrying out of the corporate purposes of the Orchard Company. There is no claim but what this contract was entered into in good faith by all parties to it. The only thing outstanding at the time of the institution of bankruptcy proceedings was the bare legal title, and the trustee in bankruptcy under the bankruptcy act upon his appointment became vested with that legal title. The only effect of the subsequent

deed was to show the purpose and intent of the previous holders of that title. There was absolutely no question at any time but what this property was the assets of the bankrupt. The trustee in bankruptcy under §70 of the Bankruptcy Act could have transferred to a purchaser an absolutely good title to this property without having received any deed at all from the Summit Investment Company. The claimant does not need to rely upon any events which happened subsequent to the beginning of bankruptcy proceedings, as there can be no question but what at the time of the institution of these proceedings the assets of the Summit Investment Company were the assets of the bankrupt corporation.

Furthermore in this contention, counsel for the trustee overlook §57(g) of the Bankruptcy Act which as interpreted by the Supreme Court of the United States provides that any preferred creditor upon his preference being recovered by the trustee, whether with or without the consent of such preferred creditor, can nevertheless prove his claim, and this, under *Page vs. Rogers,* 211 U. S. 577, (quoted from at length in our brief upon the appeal of this claimant) applies even where the preferred claimant has been guilty of actual fraud in obtaining his preference.

We note that counsel for the trustee upon page 43 of the trustee's brief, sees fit to cite from a brief of claimant's counsel which they are kind enough to say was submitted in another question. This is entirely apart from the record, but as a personal matter we would like to explain that this other question was a question which was answered by the district judge in the final paragraph upon page 48 of the transcript where he says: "If such an order were made, and the expense incurred of increasing the water supply, the claims of the contract holders for a shortage of water would still exist." We were there discussing whether the court should order that the executory contracts of the trustee personally and his friends should be specifically enforced in full at the expense of general creditors of the estate. What we said upon that question was held by the district judge to be good law and counsel for the trustee is not seeking to set it aside. Furthermore, if the entire argument from which this is a quotation were exhibited it would clearly appear that this statement is not in the slightest antagonistic to our statement in the present brief. We are now occupying exactly the same position that we occupied both before the referee and the district judge, and this is the first time that any claim has been advanced that we were inconsistent in our position.

V.

Finally, counsel for the trustee claim that inasmuch as it was Gates who turned over the stock of the Summit Investment Company, Wells can have no benefit therefrom. The claimant is not in this case seeking any benefit by reason of the reconveyance of the property. It is the trustee who is seeking to have this claimant practically fined the amount of the dividend upon his claim merely because the power of disposal of the assets of the estate was for a while vested in an individual who honorably laid down such power immediately when called upon. The claimant is not seeking any benefit through the Summit Investment Company transaction. He is merely endeavoring to prevent a transaction which never harmed any one else from harming himself. He testified that this note was never out of his possession, and was never paid nor cancelled. The trustee in opposition to this produced a statement of B. E. Gates, which states that he had purchased this note, the record of a resolution of the bankrupt company signed by the claimant assenting to this proposal of Gates to trade this note for the assets of the company and authorizing the sale of the assets of the company for this note,

and a conveyance of the title to these assets of the company to Gates. It will be noticed that there is not any statement contained in these records that this note was cancelled or paid, and payment is only an inference of fact from the combination of the record and the deed. This evidence was admissible for the purpose of supporting the contention of the trustee that the note had been paid, but it was by no means conclusive, and the referee who heard Mr. Wells' explanation and saw him while he was making the explanation believed Mr. Wells when he said that the note had never left his possession, and was not in fact paid, and the district judge has confirmed the finding of the referee. Even if the claimant had put upon his record the point blank statement that this note was paid, we fail to see how in the absence of his ever showing this to anybody it could affect his standing either legally or morally. We most certainly contend that a fine of the entire dividend upon a $56,000 claim is rather severe punishment for the entry of a misleading record which was never shown to any one and which was never used in an attempt to defraud any one.

We respectfully submit that the decision of the referee who heard this witness and all the accusations hurled at him, and nevertheless refused to

find that he had been guilty of any intentional fraud, should be sustained and his claim as approved by the referee should be ordered by this court to be approved to rank with the other claims against this estate.

Respectfully submitted,

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